

**HOLD**

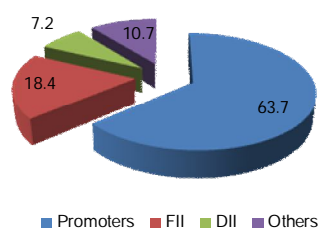
CMP*	Rs518
Target Price	Rs562

**Stock Info**

Sector	Pharmaceuticals
Market Cap (Rs cr)	53,665
52 Week High/Low	540/340
Avg. Daily Volume (3m, '000)	877
Avg. Daily Value (3m, cr)	41.6
Dividend Yield (%)	0.7
Sensex	18,197
Nifty	5,482
BSE Code	524715
NSE Code	SUNPHARMA

**Stock Performance**

(%)	Sun Pharma	NIFTY
1-week	1.2	(2.7)
1-month	4.2	(2.1)
1-year	45.6	1.4

**Shareholding Pattern (%)****Stock Price Chart**

Note: \*CMP as on July 29, 2011

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**Upsides factored****Key highlights of the result**

- **Net sales up by 19.8%:** Sun Pharma's top-line for 1QFY2012 grew at 19.8% yoy, largely driven by Taro (31% of the total sales). The domestic formulations (up 11.9% yoy) grew lower than industry growth rate due to discontinuation of third party manufacturing business, adjusting for which the sales grew at a healthy 18% yoy. The US formulations grew by a muted 1.5% yoy on a high base of 1QFY2011 (due to inclusion of high margin Eloxatin) and lower traction in generic Taxotere. The RoW grew by an astounding 306% yoy on account of Taro's sales in the RoW markets.
- **Strong operating margin boosts the PAT:** Despite the exclusion of Eloxatin sales in 1QFY2012, the gross margins remained stable at 75%, which is encouraging. The operating margins reflected a healthy trend at 33.5% on account of lower R&D and SG&A costs from Taro. Taro's OPM for the quarter stood at a strong 30%. Despite the tax credit, the high depreciation charges on account of Taro consolidation restricted the net profit at Rs501cr (down by 11.2% yoy). The decline in the bottom-line growth is due to higher base of Eloxatin in 1QFY2011.
- **Concall takeaways:** (1) The management has reiterated its guidance of 28-30% top-line for FY2012. (2) Domestic formulation is expected to grow at 18% on back of ~20-30 product launches in FY2012. It has launched 2 in-licensed products from MSD during the quarter. (3) The growth in US market has been guided at 30% on the back of sustained momentum from Taro and new product launches. (4) The R&D expenses to stay higher at ~6-7% of sales largely on account of Taro. (5) Sun filed 6 ANDAs in 1QFY2012 and has 151 ANDAs pending for approval. It has guided for 25 ANDA filings in FY2012 (6) Capex has been guided at US\$100mn for FY2012. (7) Sun has cash of US\$1bn and is looking for acquisitions in the RoW markets of Brazil, Mexico, Russia and China.

**Outlook and Valuation**

Sun is currently trading at 24.4x and 21.2x its FY2012E and FY2013E EPS respectively, very close to its peak valuation of 26x. Though we remain positive on the long term growth prospects from Taro and strong domestic franchise, we believe most of the upsides have been factored in. Further a lower return ratio due to unutilized cash, potential liability from Protonix and absence of exclusive product, restricts us from giving the company a higher multiple. Our price target of Rs562 implies 8.4% upside. **We, therefore downgrade our rating to Hold.**

**Risks to the view**

- Slowdown in domestic market
- Delay in product approvals

Year End	Net Revenues		EBITDA		Net income (adjusted)		RoaE	RoCE	EPS	Valuations (X)	
	(Rs cr)	% growth	(Rs cr)	% margin	(Rs cr)	% growth	%	%	(Rs)	P/E	EV/EBITDA
FY2010	4,103	(4.0)	1,363	33.2	1,351	(25.7)	17.3	17.7	13.0	39.7	37.8
FY2011	5,721	39.5	1,967	34.4	1,816	34.4	19.2	20.5	17.5	29.6	26.4
FY2012E	7,297	27.5	2,517	34.5	2,200	21.2	19.4	21.1	21.2	24.4	20.5
FY2013E	8,273	13.4	2,896	35.0	2,531	15.0	18.4	20.1	24.4	21.2	17.4

**Exhibit 1: Quarterly Performance (Consolidated)**

(Rs cr)	1QFY12	1QFY11	% yoy	4QFY11	% qoq	FY11	FY10	% yoy
<b>Net sales</b>	<b>1,635.7</b>	<b>1,365.1</b>	<b>19.8</b>	<b>1,463.3</b>	<b>11.8</b>	<b>5,721.4</b>	<b>4,102.8</b>	<b>39.5</b>
Material cost	407.1	335.7	21.3	313.2	30.0	1,460.7	1,193.1	22.4
% of net sales	24.9	24.6		21.4		25.5	29.1	
Staff costs	278.6	124.6	123.6	254.0	9.7	799.6	400.8	99.5
% of net sales	17.0	9.1		17.4		14.0	9.8	
R&D Expenses	88.5	56.1	57.9	90.1	(1.7)	307.7	208.3	
% of net sales	5.4	4.1		6.2		5.4	5.1	
Other expenses	314.1	232.8	34.9	362.4	(13.3)	1,186.3	937.3	26.6
% of net sales	19.2	17.1		24.8		20.7	22.8	
<b>Total operating expenditure</b>	<b>1,088.3</b>	<b>749.1</b>	<b>45.3</b>	<b>1,019.7</b>	<b>6.7</b>	<b>3,754.3</b>	<b>2,739.4</b>	<b>37.0</b>
Operating profit	547.4	616.0	(11.1)	443.6	23.4	1,967.2	1,363.3	44.3
OPM (%)	33.5	45.1		30.3		34.4	33.2	
Interest	0.0	0.0	-	0.0	-	0.0	0.0	-
Depreciation	64.7	40.2	61.0	48.2	34.2	204.1	153.3	33.1
<b>EBIT</b>	<b>482.7</b>	<b>575.8</b>	<b>(16.2)</b>	<b>395.4</b>	<b>22.1</b>	<b>1,763.1</b>	<b>1,210.0</b>	<b>45.7</b>
Other Income	96.9	11.6	737.9	110.8	(12.6)	272.7	204.8	33.1
<b>PBT</b>	<b>579.6</b>	<b>587.3</b>	<b>(1.3)</b>	<b>506.2</b>	<b>14.5</b>	<b>2,035.8</b>	<b>1,414.8</b>	<b>43.9</b>
Total tax	14.3	9.7	47.1	2.2	537.1	128.4	67.9	89.3
Tax Rate (%)	2.5	1.7		0.4		6.3	4.8	
Minority Interest	64.3	13.3	383.2	61.2		91.3	(4.1)	(2,327.1)
<b>Adjusted PAT</b>	<b>501.0</b>	<b>564.3</b>	<b>(11.2)</b>	<b>442.8</b>	<b>13.2</b>	<b>1,816.1</b>	<b>1,351.1</b>	<b>34.4</b>
Net profit margin (%)	30.6	41.3		30.3		31.7	32.9	
Extra-ordinary Items	0.0	0.0	-	0.0		0.0	0.0	-
Forex loss/(gain)	0.0	0.0	-	0.0		0.0	0.0	-
Others	0.0	0.0	-	0.0		0.0	0.0	-
<b>Reported Net profit</b>	<b>501.0</b>	<b>564.3</b>	<b>(11.2)</b>	<b>442.8</b>	<b>13.2</b>	<b>1,816.1</b>	<b>1,351.1</b>	<b>34.4</b>
<b>Reported EPS (Rs)</b>	<b>4.8</b>	<b>5.4</b>	<b>(11.2)</b>	<b>4.3</b>		<b>17.5</b>	<b>13.0</b>	<b>34.4</b>

Source: Company, RSec Research

Pricing pressures foreseen in few products due to increasing competition

**Taro:** Taro reported a 14% yoy growth in 1QFY2012 to US\$112mn with a healthy bottom-line of US\$36mn. Adjusting for the non-recurring tax credit of US\$6.6mn, the PAT stood at US\$29mn for the quarter. The Taro management has indicated that the R&D expenses will get normalized for the full year and return to the same levels of FY2011 at 9%. Note that the R&D expenses were 7% for the current quarter. Further, the management has also indicated that they are likely to witness pricing pressures in few products due to increasing competition.

**Caraco:** The ongoing issues with USFDA are yet to be resolved. However, on a positive note, the management indicated that more clarity on the issue would be revealed in 2QFY2012.

**Indian Formulations:** The domestic markets grew by 11.9% during the quarter, as Sun Pharma discontinued its third party manufacturing business. However adjusting on a like to like basis, the growth has been healthy at 18% yoy. Sun launched 7 new products in 1QFY2012. Sun expects to maintain its growth rate, driven by new product launches and has guided for 20-30 products to be launched in FY2012. It remains progressive on its chronic therapies and has identified them as the growth drivers for the Indian market.

**Emerging markets:** The RoW market grew by a phenomenal 306% during the quarter (on a low base). The growth was largely contributed by Taro's sales in the emerging markets which formed ~44% of the total emerging markets sales. However, the company does not expect to launch any further products from the MSD agreement for the next 3-4 years.

The RoW market reported a substantial growth of 306% yoy (on a lower)

### Outlook and Valuation

Sun is currently trading at 24.4x and 21.2x its FY2012E and FY2013E EPS respectively, very close to its peak valuation of 26x. Though we remain positive on the long term growth prospects from Taro and strong domestic franchise, we believe most of the upsides have been factored in. Further a lower return ratio due to unutilized cash, potential liability from Protonix and absence of exclusive product, restricts us from giving the company a higher multiple. Our price target of Rs562 implies 8.4% upside. **We, therefore downgrade our rating to Hold.**

## Profit &amp; Loss Statement

Y/E March (Rs cr)	FY2010	FY2011	FY2012E	FY2013E
<b>Gross sales</b>	<b>4,180</b>	<b>5,807</b>	<b>7,401</b>	<b>8,396</b>
Less: Excise duty	78	85	104	123
Net Sales	4,103	5,721	7,297	8,273
<b>Total Expenditure</b>	<b>2,739</b>	<b>3,754</b>	<b>4,780</b>	<b>5,378</b>
Cost of Materials	1,193	1,461	1,824	2,093
R&D Expense	208	308	438	496
Personnel	401	800	1,058	1,175
Others	937	1,186	1,459	1,613
<b>EBITDA</b>	<b>1,363</b>	<b>1,967</b>	<b>2,517</b>	<b>2,896</b>
% chg	(26.9)	44.3	28.0	15.0
(% of Net Sales)	33.2	34.4	34.5	35.0
Depreciation & Amortization	153	204	263	286
<b>EBIT</b>	<b>1,210</b>	<b>1,763</b>	<b>2,254</b>	<b>2,610</b>
% chg	(30.5)	45.7	27.9	15.8
(% of Net Sales)	29.5	30.8	30.9	31.5
Interest & other Charges	0	0	0	0
Other Income	205	273	210	210
(% of PBT)	14.5	13.4	8.5	7.4
Share in profit of Associates	-	-	-	-
<b>Recurring PBT</b>	<b>1,415</b>	<b>2,036</b>	<b>2,464</b>	<b>2,820</b>
% chg	(27.4)	43.9	21.0	14.4
Prior Period & Extraordinary Expense/(Inc.)	-	-	-	-
<b>PBT (reported)</b>	<b>1,415</b>	<b>2,036</b>	<b>2,464</b>	<b>2,820</b>
Tax	68	128	172	197
(% of PBT)	4.8	6.3	7.0	7.0
Minority Interest	(4.1)	91.3	91.3	91.3
<b>PAT (reported)</b>	<b>1,351</b>	<b>1,816</b>	<b>2,200</b>	<b>2,531</b>
Add: Share of earnings of associate	-	-	-	-
Less: Extraordinary item(EI)	-	-	-	-
<b>PAT after MI (reported)</b>	<b>1,351</b>	<b>1,816</b>	<b>2,200</b>	<b>2,531</b>
<b>ADJ. PAT</b>	<b>1,351</b>	<b>1,816</b>	<b>2,200</b>	<b>2,531</b>
% chg	(25.7)	34.4	21.2	15.0
(% of Net Sales)	32.9	31.7	30.2	30.6
<b>Basic EPS (Rs)</b>	<b>13.0</b>	<b>17.5</b>	<b>21.2</b>	<b>24.4</b>
<b>Fully Diluted EPS (Rs)</b>	<b>13.0</b>	<b>17.5</b>	<b>21.2</b>	<b>24.4</b>
% chg	(85.1)	34.4	21.2	15.0

## Balance Sheet

Y/E March (Rs cr)	FY2010	FY2011	FY2012E	FY2013E
<b>SOURCES OF FUNDS</b>				
Equity Share Capital	104	104	104	104
Preference Capital	-	-	-	-
Reserves & Surplus	7,725	9,380	11,221	13,618
<b>Shareholders Funds</b>	<b>7,829</b>	<b>9,483</b>	<b>11,325</b>	<b>13,722</b>
Minority Interest	193	847	847	847
Total Loans	171	426	376	326
<b>Total Liabilities</b>	<b>8,193</b>	<b>10,756</b>	<b>12,548</b>	<b>14,895</b>
<b>APPLICATION OF FUNDS</b>				
Gross Block	2,334	3,599	4,049	4,399
Less: Acc. Depreciation	801	1,005	1,269	1,554
<b>Net Block</b>	<b>1,533</b>	<b>2,594</b>	<b>2,781</b>	<b>2,845</b>
Capital Work-in-Progress	145	200	200	200
Goodwill on consolidation	-	-	-	-
<b>Investments</b>	<b>3,066</b>	<b>2,231</b>	<b>2,454</b>	<b>2,699</b>
Current Assets	3,712	6,017	7,435	9,538
Cash	607	2,194	2,483	3,596
Loans & Advances	849	1,128	1,824	2,482
Other	7	45	49	54
Current liabilities	758	1,423	1,459	1,525
<b>Net Current Assets</b>	<b>2,954</b>	<b>4,594</b>	<b>5,976</b>	<b>8,013</b>
Miscellaneous Expenditure	406	772	772	772
Net Deferred Tax	89	365	365	365
<b>Total Assets</b>	<b>8,193</b>	<b>10,756</b>	<b>12,548</b>	<b>14,895</b>

**Cash Flow Statement**

Y/E March (Rs cr)	FY2010	FY2011	FY2012E	FY2013E
Profit before tax	1,415	2,036	2,464	2,820
Depreciation	153	204	263	286
Change in Working Capital	467	53	1,093	924
Interest / Dividend (Net)	0	0	0	0
Direct taxes paid	68	128	172	197
Others	(1,354)	(1,004)	(2,246)	(2,730)
<b>Cash Flow from Operations</b>	<b>(185)</b>	<b>1,311</b>	<b>(439)</b>	<b>(351)</b>
(Inc.)/ Dec. in Fixed Assets	186	1,265	450	350
(Inc.)/ Dec. in Investments	1,207	(835)	223	245
<b>Cash Flow from Investing</b>	<b>(1,393)</b>	<b>(430)</b>	<b>(673)</b>	<b>(595)</b>
Issue of Equity	-	-	-	-
Inc./(Dec.) in loans	849	1,128	1,824	2,482
Dividend Paid (Incl. Tax)	332	423	423	423
Interest / Dividend (Net)	0	0	0	0
<b>Cash Flow from Financing</b>	<b>517</b>	<b>705</b>	<b>1,402</b>	<b>2,059</b>
Inc./(Dec.) in Cash	(1,062)	1,587	290	1,113
<b>Opening Cash balances</b>	<b>1,669</b>	<b>607</b>	<b>2,193</b>	<b>2,483</b>
<b>Closing Cash balances</b>	<b>607</b>	<b>2,193</b>	<b>2,483</b>	<b>3,596</b>

**Key Ratios**

Y/E March	FY2010	FY2011	FY2012E	FY2013E
<b>Valuation Ratio (x)</b>				
P/E (on FDEPS)	39.7	29.6	24.4	21.2
P/CEPS	7.1	26.6	21.8	19.1
P/BV	1.4	5.7	4.7	3.9
Dividend yield (%)	2.7	0.7	0.7	0.7
EV/Sales	2.2	8.9	7.0	6.0
EV/EBITDA	37.8	26.4	20.5	17.4
EV / Total Assets	1.1	5.2	4.4	3.6
<b>Per Share Data (Rs)</b>				
EPS (Basic)	13.0	17.5	21.2	24.4
EPS (fully diluted)	13.0	17.5	21.2	24.4
Cash EPS	72.6	19.5	23.8	27.2
DPS	13.8	3.5	3.5	3.5
Book Value	378.0	91.6	109.4	132.5
<b>Returns (%)</b>				
RoCE	17.7	20.5	21.1	20.1
RoIC	18.8	26.2	27.9	28.2
RoE	17.3	19.2	19.4	18.4
<b>Turnover ratios (x)</b>				
Asset Turnover (Gross Block)	1.7	1.6	1.8	1.9
Inventory / Sales (days)	96	81	74	65
Receivables (days)	96	75	69	78
Payables (days)	52	65	72	67
WCC (days)	209	153	175	195

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